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Diversification into Man-Made Fiber Apparel Exports

A Strategic Option for Madagascar to Maximize Post-2004 Preferential Tariff Margins

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Contents

Contents (continued)

ILLUSTRATIONS

Tables

Executive Summary

This report recommends that garment producers in Madagascar consider diversifying into exports of apparel made primarily from man-made fiber in order to maximize post-2004 tariff preferences. Currently, the overwhelming majority of Madagascar's apparel exports are cotton, but Madagascar does export some man-made fiber apparel products.

As producers and the Government of Madagascar are well aware, World Trade Organization (WTO) Agreement on Textiles and Clothing (ATC) quotas will be eliminated on January 1, 2005. Subsequently, Madagascar's preferential access to the U.S and EU markets will be defined solely by tariff preferences and rules of origin rather than, to a large degree, by quotas. Under the U.S. Africa Growth and Opportunity Act (AGOA), tariffs on qualifying apparel products are completely eliminated for Madagascar and other beneficiaries. Because average and peak U.S. tariffs on apparel made from man-made fibers are considerably higher than those on apparel made from cotton, AGOA preferred access confers a considerably greater competitive advantage on beneficiary exports of clothing made primarily from man-made fiber than it does on cotton clothing. Consequently, Madagascar might reap substantial gains should it successfully diversify into man-made fiber apparel exports to the United States. EU tariffs on cotton and man-made fiber apparel do not differ in the same way so developing country preferences under the Africa Caribbean and Pacific (ACP)/Cotonou Agreement and the Everything But Arms (EBA) provision of the Generalized System of Preferences (GSP) do not confer the same opportunity to gain from a strategic decision to diversify. Nonetheless, if producers in Madagascar decide to diversify in response to opportunities in the U.S. market, they might also discover opportunities to gain from an expansion of their man-made fiber apparel exports in the EU.

Since Madagascar does not have a local source of man-made fibers in commercial quantities, producers interested in exporting apparel made from such fibers will have to import fabrics and possibly yarns. The sourcing of foreign fibers and fabrics for use in apparel made in Madagascar for which preferential access to the U.S. or EU market is sought is subject to rules of origin. Those rules define which apparel will be certified for complete relief from duties and quotas in the importing country. Some uncertainty now surrounds U.S. AGOA and EU rules of origin. To successfully diversify into exports of man-made fiber apparel to the United States and EU regardless of whether the AGOA special rule is temporarily extended and regardless of the specific outcome of Madagascar's negotiation regarding an Economic Partnership Agreement (EPA), producers in Madagascar must become familiar with U.S. and EU rules of origin and develop a solid knowledge of reliable sources of man-made fabric and yarn in Asia and within the sub-Saharan region.

The Government of Madagascar and international donors can offer to support Malagasy apparel producers attempting to diversify into exports of man-made fiber apparel. First, donors could assist by providing technical staff to describe the details of new, though not vastly different, skills required for the construction of man-made fiber apparel. Second, donors and the Government of Madagascar could support regional partnerships and joint marketing efforts by regional textile and apparel producers to reduce the risks associated with changing rules of origin and to form stronger links to developed markets. Finally, the Government of Madagascar, with input from the private sector, can negotiate or advocate for favorable U.S. and EU rules of origin. For example, the Government should consider paying particular attention to sorting out its priorities for negotiating an EPA so it does not unintentionally forego the rule of origin benefits of the ACP/Cotonou Agreement, which expires in 2007.

Apparel producers and the Government of Madagascar, with some support from the United States and other members of the international donor community, have taken important steps in recent years to expand the industry and its exports. Their efforts have had some success. In recent months, they have established important lines of industry-specific public–private communication to transform that success into a strategic plan for sustainable future growth. Further, public and private sector interest in strengthening the process for making trade-related policy and for arriving at trade negotiating positions is growing. Consequently, apparel producers and the government are well-positioned to consider the strategic option of diversifying into the export of man-made fiber apparel, to integrate that option into a national strategy for the apparel industry, and to execute that strategy with support from the international donor community.

1. Introduction

For more than 30 years, exports of textiles and apparel between developed and developing countries have been tightly regulated by quotas. Shielded from competition by quotas, many countries like Madagascar have built substantial export sectors for these products. In less than one year, apparel exporters in Madagascar will likely encounter a dramatically different competitive environment for their apparel products. To be successful, suppliers must adapt rapidly to the new trade environment.

Previous presentations by the International Trade Center (ITC) and by USAID/Madagascar's "Jumpstart" project in Madagascar have broadly outlined the seismic changes confronting the global textile and apparel industries and Madagascar due to the elimination of U.S. and EU quotas on January 1, 2005, and the accession of China to the WTO in 2002. Related ITC and USAID/Madagascar "Jumpstart" reports and analyses, as well as other work by the World Bank under the auspices of the Integrated Framework, have suggested numerous options for improving the competitiveness of Madagascar's textile and apparel exports. These analyses focus on the fundamentals of Madagascar's business-enabling environment such as domestic transportation, government institutions, and port and customs infrastructure. They also suggest that Madagascar consider strategic options such as integration of the cotton, textile, and apparel value chains to satisfy AGOA rules of origin and ultimately reduce lead times, lower costs, and increase value-added in Madagascar.

This report complements earlier reports and analyses. Currently, Madagascar's apparel exports are primarily in products constructed from cotton. Here we recommend that apparel producers in Madagascar consider diversification into exports of man-made fiber apparel as a strategic option for maximizing post-2004 preferential tariff margins. First, we identify opportunities for Madagascar to diversify that arise from the January 2005 quota elimination. Second, we discuss challenges that the industry and the Government of Madagascar (GOM) will need to take on in order for diversification to be successful, especially those challenges associated with U.S. and EU trade preference program rules of origin in transition. Finally, we suggest ways in which the GOM and international donors can support a strategic decision by apparel producers in Madagascar to diversify into exports of apparel made primarily from man-made fiber.

2. Opportunities for Madagascar to Diversify into Man-Made Fiber Apparel Exports

Inherent to all markets, risk can take many forms, including changing regulations, consumer preferences, and patterns of competition. To be successful in any market, a firm must reduce risks as much as possible and manage those that remain. A principal method for reducing and managing risk is to diversify into new geographic and product markets. When a firm diversifies, it knowingly forgoes short-term profits in the interest of achieving and sustaining long-term growth. Diversification has a long history in financial markets and the business plans of most global companies.

Diversification has a shorter history in developing countries seeking sustainable development in the face of the risks associated with global markets. In the global textile and apparel markets, 40 years of highly regulated trade have created an environment in which many developing countries have become accustomed to relying on protected markets in developed countries. Textile and apparel quotas have shielded less competitive suppliers from competition. When quotas are eliminated on January 1, 2005, apparel exporters in Madagascar and other developing countries will face open competition in uncertain and rapidly shifting markets. Diversification of geographic and product markets can be a useful component in Madagascar's national, industry, and firm-level strategies to compete in those markets.

As discussed in previous reports, Madagascar's obvious strengths in apparel include abundant labor, the potential for a vertically integrated cotton apparel supply chain, and preferential access to U.S. and EU apparel markets. The details of that preferred access and related changes that will occur when quotas are eliminated suggest that Madagascar will be better able to exploit its margins of preference post-2004 if it diversifies into the export of apparel made from man-made fiber. Diversification implies stretching beyond the range of what is currently being done. It poses some challenges and is a long-term objective.

AGOA Eliminates High Average Tariffs

Table 1 shows that more than 75 percent of U.S. imports of apparel from Madagascar are constructed principally of cotton materials while only 60 percent of U.S. apparel imports are cotton. Relevant to our interest in the benefits to Madagascar of diversification, U.S. imports from Madagascar of apparel constructed chiefly of man-made (synthetic and artificial) fibers has grown particularly rapidly. While Madagascar's exports of cotton products nearly doubled over the 2002–2003 period, exports of man-made fibers tripled from a small base of less than 10 percent. These market shares and growth trends provide some perspective for evaluating the factors that affect the potential for seeking gains from diversification.

Table 1
U.S. Imports of Apparel from Madagascar and the World by Textile Fiber Type, 2002-2003

	From Madagascar				From the World	
	2002		2003		2003	
Fiber	Million Dollars	Share	Million Dollars	Share	Million Dollars	Share
Cotton	72.6	81.4	151.6	77.3	36,116.0	59.0
Wool	9.1	10.2	22.9	11.7	3,519.7	5.8
Man-made	7.5	8.4	21.6	11.0	19,179.8	31.4
Other	0.1	0.1	0.2	0.1	2,349.0	3.8
Total	89.3	100.0	196.0	100.0	61,164.5	100.0

SOURCE: *U.S. Department of Commerce Office of Textiles and Apparel. Calculations by Nathan Associates.*

The rapid growth in Madagascar's man-made fiber apparel exports may appear to contradict the expectations of conventional competitiveness theory, which would point to Madagascar as an important source of raw cotton fiber. Competitiveness in the apparel industry, however, is determined by a variety of factors, including market access, buyer networks, and supply chain efficiency in addition to natural endowments.[1] Table 2 shows that producers in Madagascar have already successfully challenged this conventional wisdom in the EU market where non-cotton products account for approximately half of Madagascar's apparel exports.[2]

Table 2
EU Imports of Apparel from Madagascar and the World by Textile Fiber Type, 2001-2002

	Madagascar				World	
	2001		2002		2002	
Fiber	Million Dollars	Share	Million Dollars	Share	Million Dollars	Share
Cotton	123.1	51.7	79.2	58.8	22,437.9	47.3
Wool	45.6	19.2	11.8	8.8	2,871.1	6.0
Man-Made	13.1	5.5	9.0	6.6	16,594.1	35.0
Other[a]	56.0	23.5	34.5	25.7	5,469.4	11.5
Total	237.9	100.0	134.6	100.0	47,459.2	100.0

SOURCE: *EuroStat data and calculations by Nathan Associates.*

[a] *"Other" includes silk and non-wool animal fibers. In 2002, the EU imported nearly 20 million dollars in silk scarves and accessories from Madagascar. EU imports of tops made of non-wool animal fibers were also significant.*

The U.S. African Growth and Opportunity Act (AGOA) grants Madagascar duty- and quota-free access to the U.S. market for qualifying apparel. The trade-weighted most favored nation (MFN) tariff and the tariff equivalents of quotas that constrain non-preferred exporters to the United States, principally Madagascar's Asian competitors, are presented in Table 3. These data make clear the value to Madagascar of preferred access to the U.S. market.[3] Table 3 shows, for example, that were it not for AGOA, U.S. importers of cotton apparel from Madagascar would be required to pay a 15 percent tariff on those imports on average and that the average tariff equivalent of quotas for cotton apparel imports is 30 percent on top of that. The average tariffs for apparel made from synthetic and "other" fibers are 23 and 22 percent, respectively; and the quota tariff equivalents are 27 and 8 percent. Together,

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[1] Conventional economic theories of competitiveness emphasize natural endowments, such as land, labor, and raw cotton.
[2] The EU imported 17 million dollars in silk scarves and accessories from Madagascar in 2002.
[3] Technically, the tariff equivalents of quotas presented in Table 3 are average export tax equivalents of quotas rather than tariff equivalents since the quotas are applied at the factory gate rather than at the port of entry. For simplicity of understanding and because the two measures of quota value are similar, we refer to them here as tariff equivalents. Further, these quota equivalents should be used only as a rough guideline because export tax equivalents of quotas can suffer from large estimation errors and considerable variation among products.

average tariffs and quota tariff equivalents add up to protection on the level of 45, 50, and 30 percent respectively for apparel made primarily from cotton, synthetic, and "other" fibers.

Table 3
U.S. Tariffs and Quota Tariff Equivalents by Fiber Type

Fiber	Trade Weighted MFN Tariff (%)	Quota Tariff Equivalent (%)	Total Protection = Tariff + Quota Tariff Equivalent
Cotton	15	30	45
Synthetic	23	27	50
Other (wool, man-made)	22	8	30

In addition to quantifying the magnitude of the benefits available to Madagascar via AGOA's duty- and quota-free access for qualifying apparel, Table 3 also reveals an important difference in the make up of the preferred access provided for apparel products, depending on the type of fiber from which they are made. For cotton apparel, quotas provide the major portion of the benefit from preferential access to the U.S. market. The tariff equivalent of the quotas on cotton apparel is double the trade-weighted tariff. In other words, more than two-thirds of the benefit of AGOA preferential access to the U.S. market for cotton products will be eliminated with quotas on January 1, 2005.

The margins of preference provided by both duty- and quota-free access to the U.S. market are higher for apparel constructed of man-made fibers than for apparel constructed of cotton. And, in contrast to the case of cotton apparel, tariffs on man-made fiber apparel make up almost 50 percent of Madagascar's preferred access to the U.S. market.[4] In other words, half of the margin of preference that is currently provided AGOA exports of man-made fiber apparel from Madagascar will remain intact even after quotas are eliminated in January 2005, whereas only one-third of the margin of preference on cotton apparel will remain. This is of major strategic importance to Madagascar.

[4] Nearly 90 percent of Madagascar's cotton apparel exports are in the two most sensitive U.S. quota categories—cotton trousers and cotton knit shirt. These categories have the largest number of Asian countries (15 and 13, respectively) constrained by quotas. Therefore, these averages likely underestimate the benefits of Madagascar's quota-free access to the U.S. market.

AGOA Eliminates High Tariff Peaks

Although the average tariffs in Table 3 identify opportunities for Madagascar to diversify its apparel exports in a quota-free world—and the clear benefits thereof—they mask important variations in specific tariff lines that increase the magnitude of the margin of preference that Madagascar could exploit even beyond that shown in Table 3. A careful examination of the U.S. tariff schedule at the product level reveals peak U.S. MFN duties on apparel constructed from man-made fiber in excess of 30 percent, while tariff peaks for cotton apparel rarely reach 20 percent and are clustered around 16 percent. Again, AGOA completely eliminates the tariffs on those products. Malagasy exporters would, therefore, do well to consider diversifying into man-made fiber apparel tariff lines with higher U.S. tariffs to fully exploit the benefit of the margin of preference that AGOA duty-free access provides them over non-preferred competitors in those categories.

Table 4 lists the most promising targets for diversification into apparel constructed from man-made fiber, based on tariff preferences in the U.S. market: (1) woven and knit trousers; breeches, and shorts; (2) shirts and blouses; (3) dresses; (4) nightwear, bathrobes, and pajamas; and (5) coats, overcoats, capes, and windbreakers. Several products are major apparel products with high import volumes and for which U.S. tariffs on man-made apparel are substantially higher than other fibers, including cotton.[5] Table 4 shows that the largest import category—trousers, breeches, and shorts—represents more than $14 billion in world imports. The tariffs on man-made fiber products in this category, shown in Table 4 as 28.2 percent for knit and 28.3 percent for woven, are more than 12 percentage points higher than the tariffs on cotton products in this category. The tariff premium on man-made fiber products over cotton products in this category is more than 12 percent. In fact, the 12.7 percent tariff premium on man-made knit trousers is nearly as high as the 15.5 percent tariff on cotton knit trousers itself. In other words, the tariff preference on man-made trousers is nearly double the tariff on cotton trousers.

For the major products shown in Table 4, the average tariff on cotton products is only 56 percent of the average tariff on man-made fiber apparel. Two-thirds of Madagascar's exports are in the two leading products in Table 4 (cotton trousers and knit shirts). This indicates the magnitude of the gains available to Madagascar from diversification into exports of apparel constructed from man-made fibers.

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[5] Several major product categories such as women's skirts and swimsuits are not listed in Table 4 because they do offer significant margins of preference either in absolute terms or relative to cotton products.

Malagasy producers using the maximum tariff advantages presented in Table 4 could further leverage their competitiveness by targeting specialized products differentiated from the mass market apparel produced by large Asian producers. For example, synthetic athletic wear such as knit shirts, shorts, and trousers with special prints and cuts provides opportunities that are often too small to attract major Asian suppliers. College and team apparel are perfect examples of such specialized apparel. Because such garments are relatively standardized production and shipping can be planned well in advance. Additionally, women's specialty dresses and blouses with unique prints and styles are the mainstay of small and medium department store chains.

Table 4
U.S. Apparel Imports, 2003

Product	Cotton Fiber			Man-Made Fiber		
	Imports (Million US$)		MFN Tariff	Imports (Million US$)		MFN Tariff
	World	Madagascar		World	Madagascar	
TROUSERS, BREECHES AND SHORTS						
Knit	1,267.2	9.3	~15.5	937.1	6.2	28.2
Woven	10,115.5	74.5	16.6	2,203.1	0.9	~28.3
SHIRTS AND BLOUSES						
Knit	2,196.0	9.2	20.0	624.5	1.8	32.0
Woven	3,434.9	3.5	~17.6	1,364.5	0.5	~26.4
DRESSES						
Knit	137.3	0.1	11.5	173.0	0.5	~15.5
Woven	220.0	0.3	8.4	708.7	0.1	16.0
NIGHTWEAR, BATHROBES AND PAJAMAS						
Knit	765.3	1.3	~8.9	467.8	0.0	16.0
Woven	365.2	0.0	~8.9	220.7	0.0	16.0
COATS, OVERCOATS, CAPES AND WINDBREAKERS						
Knit	414.1	1.9	15.9	429.8	2.1	28.2
Woven	89.4	0.1	8.9	101.0	--	27.2
Average\Total	19,004.9	100.2	13.2	7,230.2	12.1	23.4

SOURCE: *U.S. Harmonized Tariff Schedule, 2004 – http://USITC.GOV.*

Note: The symbol "~" indicates average values since there are often small variations in tariffs within product categories that do not amount to more then 5 percent of the average tariff value.

3. Challenges to Diversifying Fiber Types—Rules of Origin

Since Madagascar does not have a local source of man-made fibers in commercial quantities, producers interested in diversifying into the export of apparel made from man-made fibers will have to import appropriate fabrics and possibly yarns. The sourcing of foreign fibers and fabrics for use in apparel made in Madagascar for which preferential access to the U.S. or EU market is sought is subject to rules of origin. Those rules define which apparel will be certified for complete relief from duties and quotas in the importing country. Considerable uncertainty now surrounds U.S. AGOA and EU rules of origin. To successfully diversify into exports of man-made fiber apparel to the United States and EU regardless of whether the AGOA special rule is extended, producers in Madagascar must be become familiar with U.S. and EU rules of origin and develop a solid knowledge of reliable man-made fabric and yarn sources in Asia and within the sub-Saharan region.

U.S. Rules of Origin

STANDARD AGOA RULE OF ORIGIN

In general and up to a capped quantity that has never been reached, the standard AGOA rule of origin deems apparel assembled in Sub-Saharan Africa from fabric wholly formed in Sub-Saharan Africa from U.S. or Sub-Saharan African yarns to be eligible for duty- and quota-free treatment. These garments may contain up to 7 percent of their weight in yarns of foreign origin (i.e. not wholly of U.S. or Sub-Saharan African origin.[6]

Under the standard AGOA rule, the fibers (cotton, wool, staple, or tow) and chemical polymers (i.e., man-made fibers) used in these garments may be of any origin (e.g., from the United States, Sub-Saharan Africa, or elsewhere). A more stringent rule applies to garments known as knit-to-shape as well as to those known as circular knit or seamless knit garments because they involve minimal cutting and sewing. AGOA requires that the fibers used to make these garments originate only in Sub-Saharan Africa or in the United States.

Finally, the AGOA standard rule of origin does allow for tolerance in the cases of findings or trimmings (buttons, zips, elastic bands, snaps, or decorative lace) of foreign origin, up to a maximum of 25 percent of the cost of the components in the finished garment. It also provides tolerance for specific piece good inner linings of foreign origin.

AGOA SPECIAL RULE FOR LDCS

AGOA provides an exception to its standard rule of origin for least developed countries (LDC), such as Madagascar, through September 2004. The exception permits LDCs to use fabric and yarns from non-U.S. and non-Sub-Saharan African sources. Like most AGOA provisions, the use of non-regional materials is subject to a cap that has never been filled. Legislation passed by the U.S. Congress and awaiting President Bush's signature would extend the special exception for LDCs for three years through September 2007. Of equal importance, this legislation would extend AGOA benefits (without the special exception for LDCs) to 2015 to give producers and investors the certainty necessary for long-range production and sourcing plans.

EU Rules of Origin

The EU tariff structure and Madagascar's preferred access to the EU apparel market do not impart advantages or differentials based on fibers and fabrics that mirror the U.S. case, and peak EU MFN tariffs on apparel are all tightly clustered around 12

[6] AGOA caps (i.e. limitations) on preferential access are usually defined according to the combined amounts of U.S. materials and threads used in making the garments in question. Thus far regional (i.e., Sub-Saharan) producers have never reached any of these caps. If Sub-Saharan African producers ever do reach these caps, more complicated and restrictive rules of origin would likely emerge.

percent.[7] Still, if apparel producers in Madagascar decide to diversify further into the production of man-made apparel products in order to maximize post-2004 preferential tariffs in the United States, it would make sense for them to also seek opportunities to export more man-made apparel to the EU. In that regard, they should develop a clear understanding of EU preferential rules of origin, which for garments fall under two separate programs for Madagascar: the Africa Caribbean and Pacific (ACP)/Cotonou Agreement and the Generalized System of Preferences (GSP). While the two programs' descriptions of tariff preferences ("elimination of tariffs") appear similar, crucial differences in their rules of origin cause actual preferences to be substantially and materially different.

In general, EU rules of origin require two significant processes to be performed within the defined country or region of origin in order for a preferred exporter to obtain official certification of origin and relief from tariffs. The concept of significant process is highly technical and legalistic. However, in many cases, significant transformation results in official reclassification of a product from one tariff heading to a completely different heading.[8] In industry terms, this means garment construction (making-up), must be coupled with one other significant process. In most cases, this means "forming of fabrics or yarns." Except in a few circumstances, dying and finishing fabric and/or a garment is not sufficient to confer origin (although an important exception, explained below, exists for printed fabric).

ACP/COTONOU[9]

The Cotonou Agreement provides for complete relief (elimination) of import duties for apparel meeting the rule of origin provided in the agreement. According to the agreement, garments (including cotton, wool and man-made fibers) for which relief from EU tariffs is claimed may be constructed of foreign (non-regional) yarn, but fabrics must be formed (knit or woven) and made-up into a garment in one or more of the ACP countries. Under this liberal, so-called "full-cumulation" clause Mauritian textile producers, for example, can import yarn from Asia, knit or weave the yarn into fabrics that are then made-up into garments in Madagascar and

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7 Important exceptions to the general 12 percent EU tariff on apparel include the following: knit wool jerseys and pull-over (8.5 percent), gloves and mittens, (8.5 percent), elastomeric knit swimwear (8 percent), non-knit babies garments (10 percent), women's support garments (6.5 percent), handkerchiefs (10 percent), gloves, scarves and veils and the like (8 percent) and ties (6.0 percent).

8 The EU provides a separate list for products that do not follow this general rule.

9 This section is based on information drawn from interviews conducted with Frencesco Marchi at EuraTex and with Edwin Vermulst,a Rules of Origin attorney on May 18, 2004.

certified for duty-free access to the EU.[10] As with the U.S. rule of origin, a major exception exists for knit-to-shape garments, such as circular knits and seamless garments, which require that the yarn be spun in an ACP country, in addition to constructing the fabric and making-up (which is minimal in this case).

All garments for which duty-free treatment is sought must be shipped directly to the EU without entering the customs territory of any other country, though allowance is made for goods shipped to foreign ports but not entering the customs areas of another country and stored solely for onward freight.

Exceptions to these general rules are limited, covering primarily products containing significant embroidery and impregnated fabrics. An opportunity does exist for Malagasy producers to leverage EU rules of origin for apparel constructed of printed fabrics. EU rules allow for the use of non-regional (non-ACP) fabrics in made-up garments, if the non-regional fabrics are printed in the ACP region. The printing, however, must add at least 52 percent to the value of the fabric.[11] Further, a tolerance of 15 percent non-regional content is provided like that provided for findings, trimmings, or non-originating fibers and yarns.

THE EVERYTHING BUT ARMS PROVISION OF THE EU GSP

As an LDC, Madagascar is eligible for complete tariff elimination under the EU GSP program for LDCs, the Everything But Arms (EBA) provision. The standard EU GSP provides for 20 percent relief for apparel imports from many developing countries. The EBA provision allows complete relief for certain LDCs, including Madagascar. Since the EBA is a part of the EU GSP arrangement, GSP rules of origin apply.

In contrast to the Cotonou Agreement which provides a 15 percent tolerance, the EU GSP provides only 10 percent tolerance for non-originating findings, trimmings, and components. There is no cumulation with other sub-Saharan African producers.

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[10] An exception to this rule is made for embroidered apparel for which a value-added threshold must be met. The ACP/Cotonou Agreement provides for full cumulation among ACP members, but the region's largest manufacturer of textiles, South Africa, is not an ACP member. Consequently, its textiles cannot be included in such cumulation to meet the origin requirement. The ACP/Cotonou Agreement does provide through a separate provision for cumulation with South Africa, but the ACP and South Africa have never implemented that provision. Not insignificantly, diagonal cumulation requires harmonized rules of origin among member states.

[11] Application of the printing provision in the EU rules of origin has been controversial as the definition of "printing" is interpreted by individual EU customs authorities differently. Exporters seeking to utilize this provision to claim preferential access to the EU should, therefore, consult local EU customs officials or brokers with knowledge of the application of these rules which may change from time to time.

Therefore, garments must be constructed of fabrics formed in Madagascar or the EU (including any dying and finishing).

Implications of Rules of Origin for Garments Constructed of Man-made Fibers

U.S. and EU rules of origin for garments constructed of man-made fiber have implications for garment producers in Madagascar interested in diversifying into these products. They will enjoy a considerable competitive advantage in the U.S. market after quota elimination in January 2005 because of AGOA's complete elimination of tariffs on man-made garments, which range from 28 to 32 percent. True, that competitive advantage will be partially offset by the relatively high logistics and materials costs associated with wholly regional man-made apparel garments. Still, because their fiercest competitors will face high tariffs and they will not, producers in Madagascar could nonetheless net a strong competitive advantage.

They will enjoy that competitive advantage whether they use fabrics and fibers from the region(primarily South Africa) or from Asia (should the special AGOA rule for LDCs be extended).

Extension of the AGOA special rule for LDCs would have advantages and disadvantages for apparel producers in Madagascar that are interested in diversifying into exports of man-made fiber apparel. On the one hand, extension of the rule would allow Madagascar and other African producers to continue to source Asian fabrics at the most competitive prices and still have their exports to the United States of man-made fiber apparel relieved from duties as high as 32 percent. In the post-2004 quota free world, preferences will be determined by tariffs and rules of origin rather than substantially by quotas, so they would, therefore, enjoy the greatest competitive advantage of any post-quota-world preferential supplier to the U.S. man-made apparel market. There is no question that this amounts to a decidedly distinct advantage that would provide Madagascar with an opportunity to establish a foothold in the U.S. man-made apparel market and to explore the EU market as well.

On the other hand, extension of the AGOA special rule for LDCs and any uncertainty surrounding it could hamper the development of a regional textile supply chain—reducing incentives for investments in logistics management, equipment, and business partnerships. Asian intermediaries direct much of the fabric and apparel sourcing in Madagascar and other Sub-Saharan countries. These intermediaries tend to prefer Asian suppliers and tend not to be fully vested in developing an African supply chain. Further, as long as large U.S. apparel buyers have the option of importing from apparel producers that use familiar Asian fabric suppliers and still qualify for duty-free access under the AGOA special rule for LDCs, they also are unlikely to seek out and build partnerships with African suppliers.

Despite the short-term signals of these dominant actors in the global apparel market, Madagascar's apparel producers interested in diversifying should forge alliances with input producers both in Asian and in the AGOA region who can meet U.S. and EU rule of origin requirements. The appendix includes several producers in South Africa that have experience exporting to the US and EU markets. With both sets of alliances, apparel producers in Madagascar can take advantage of the AGOA special rule for LDCs as long as it is available but will also be positioned to meet the standard AGOA rule of origin. While the AGOA special rule for LDCs may be extended until 2008, it is not likely to be extended beyond then.

4. Implementing the Diversification Strategy: Recommendations

Successful diversification requires a long-term strategic commitment on the part of industry. Developing a strategic vision is only the first step in achieving the desired end. Beyond that, governments and\or industries seeking to diversify their export or product base must overcome serious challenges. International donors and the Government of Madagascar can and should support the process.

First, international donors can provide technical assistance and information to help producers in Madagascar understand and meet the technical requirements for switching from cotton to man-made fiber based apparel production. For example, they could arrange for fabric producers and other specialists to come to Madagascar to share information and conduct training. Producers will require some technical assistance and information and this approach has been used with some success in South Africa and the Caribbean.[12] Producers in South Africa and the Caribbean that have switched from manufacturing cotton garments to man-made fiber based garments report that some retraining is necessary but that new skill sets and equipment are not vastly different from that required for the manufacture of cotton garments. U.S. buyers and consultants agree. They say that switching appears to be more a factor of "producer culture" and buyer relationships then technical skills.

Second, international donors and the Government of Madagascar can encourage producers in Madagascar to foster regional business partnerships. Strong partnerships with quality fabric and yarn suppliers in the region can serve two ends. First, such regional partnerships reduce producers' uncertainty by expanding the

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[12] Both Unifi (USA) and BMD textiles (South Africa) reported proactive programs to help garment producers to switch fabric types. BMD textiles has organized d mutual trade missions (BMD and new apparel suppliers) to the US, returning with interested buyers, but insufficient interest from apparel produces dedicated to cotton products.

potential supply base for fabrics and yarns. (It is unlikely that the AGOA special LDC rule, now set to expire on October 1, 2004, will be extended beyond 2008). By 2008, Madagascar will have had to transition from the EU Cotonou Agreement (with its regional cumulation clause) to an EPA. If not, its preferences will, by default, be limited to those provided under the EBA provision of the EU GSP, which does not include a regional cumulation clause.[13] Consequently, sourcing competitively priced imported fabrics and yarns that meet the AGOA and EU rules of origin regardless of upcoming potential temporary and/or permanent changes will be crucial for a product diversification plan.

Second, strong regional partnerships will give Malagasy apparel producers a new link to U.S. buyers. Any strategy for diversifying products within the apparel industry will require cooperation with U.S. and EU buyers. In interviews, some U.S. buyers have indicated that they intend to continue searching for qualified preferential suppliers of man-made fiber apparel to obtain relief from peak U.S. tariffs of 28–32 percent, even if this runs counter to the global industry's trend toward consolidation of orders in response to the elimination of textile and apparel quotas in January 2005. While few avenues offer as much potential for achieving U.S. buyer cooperation as forging direct relationships with them, developing these direct market channels is likely to be difficult for producers in Madagascar—not least because of the language barrier. Therefore, in addition to making direct contact with U.S. buyers, producers in Madagascar should (1) relay to current buyers, typically in Asia, their intent to build capacity as a source of man-made fiber apparel; and (2) forge alliances with regional yarn and fabric producers. The latter strategy is perhaps the best way to leap the hurdle of achieving direct market linkages, since yarn and fabric suppliers often attend foreign conventions and have already established linkages to small and medium buyers in foreign markets. Supporting joint regional marketing efforts by yarn, fabric, and apparel producers could accelerate a successful diversification strategy in Madagascar while strengthening integration of the supply chain.

The AGOA special rule for LDCs is almost certain to be phased out by 2008. Even so, there remains a strong market incentive to use non-regional fabrics as long as they are permitted for preferential programs. In the spirit of intervening when market signals fail, a government- and international donor-supported strategic plan in this

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[13] There would be little advantage to an EPA agreement for many LDCs since the tariff benefits are similar. This view does overlook the fact that GSP provisions are unilateral, and are hence subject to change. Investors requiring medium to long-term assurance will view the two paths differently. Additionally, the EU-EBA agreement does not support cumulation of inputs in the region (Mauritian or South African).

area could be appropriate and helpful. Business partnership could be facilitated by identifying Malagasy producers interested in diversifying into non-cotton fabrics and introducing them to qualified producers in the region.

Third, the Government of Madagascar can negotiate/advocate with input from the private sector for favorable U.S. and EU rules of origin. For example, the government should consider paying close attention to sorting out its priorities for an EPA so it does not unintentionally forego the rule of origin benefits of the ACP/Cotonou Agreement, which expires in 2007. There, Madagascar will need to determine any meaningful benefits that can be achieved through regional partnerships as those benefits will hinge on cumulation provisions in any new EPA agreement or, alternatively, the lack thereof in the EU-EBA program. This is so for garments of all fiber types, including cotton. In the case of AGOA, the Government of Madagascar and the industry will have only limited influence over the possible extension of the third-country fabric provision, since the AGOA is unilateral and not negotiated and subject to significant congressional debate.

5. Conclusion

Madagascar's apparel exports are primarily in products constructed of cotton. Analysis of U.S. tariffs and quotas makes clear the value of diversification into man-made fiber apparel exports as a strategic option for Madagascar to maximize its post-2004 preferential tariffs. After quota elimination in January 2005, peak tariffs on man-made fiber apparel will still offer margins of preference of between 28 and 32 percent on selected products. In contrast, duties on apparel made principally of cotton average only about 16 percent and peaks rarely exceed 20 percent.

To take advantage of these peak tariff preferences, Madagascar needs to develop sources of imported materials that producers can use and still be eligible for preferential access to the United States and EU. Partnerships with regional suppliers of man-made fiber textiles are also an important way for Malagasy producers to minimize risks associated with potential new rules of origin in U.S. and EU preferential programs. And joint marketing by regional textile and apparel suppliers of man-made fiber apparel may be the best way to develop direct linkages to new customers in developed markets.

To adapt to the rapidly changing global market for apparel products and to sustain related export growth, apparel producers will require the support of the Government of Madagascar and assistance from international donors. Diversifying into exports of apparel constructed from man-made fibers, as recommended in this paper, is one way that producers can adapt to the new global trade environment. The technology and skills required to produce man-made fiber apparel are not vastly different from those required to produce cotton products, but some technical training and information will be required. Donors can assist by providing technical staff that can describe the skills required for the construction of man-made fiber apparel. Second, regional partnerships could reduce the risks associated with changing rules of origin and strengthen links to developed markets. The Government of Madagascar and development agencies would do well to support joint marketing by regional textile and apparel producers to build regional partnerships. Finally, the Government of Madagascar is well aware that it is entrusted with negotiating and advocating for favorable U.S. and EU rules of origin. Doing so poses both a political and technical challenge. In particular, the importance of provisions in the EU ACP/Cotonou agreement for using regional yarns and materials must be assessed to determine priorities for negotiating a new EPA with the EU, before the ACP/Cotonou agreement expires in 2007.

Appendix. South African Textile Firms

The South African Textile Federation (Texfed) produces a directory of firms that can be obtained from the following address:

Textile Federation
P.O. Box 53
Bruma
2026 – Republic of South Africa
Tel: +27 (011) 615-4007 or +27 (011) 615-9853 or +27 (011) 615-9856
Fax: +27 (011) 615-9857
E-mail: texfed@jhbmail.co.za

The directory currently costs 100 ZAR Rand. A copy of the 2002/2003 directory can be consulted in Madagascar from the following people:

Alain Pierre Bernard Tel: Fax: E-mail:	John Hargreaves - Vice President of GEFP Tel: Fax: E-mail:

A list of Textile Federation firms can be found at http://www.texfed.co.za. Once logged onto the site, click on "Members." Firms are listed by product and basic contact details are provided. The websites of individual companies should be checked to confirm contact details.

Another list of 89 firms can be found at the website of the South African Textile Industry Export Council. Firms are classified according to product type (fibers, yarns, fabrics as well as made-up home textiles and made-up technical textiles). Individual firm contact details are provided at http://www.satiec.co.za/ . Again, the websites of individual companies should be checked to confirm contacts. We recommend consulting the directory. However, if you decide to obtain information from the internet, then have a look at ***both*** the aforementioned websites.

Texfed provides advice, information, and additional contact points. Texfed can provide a map to their offices by e-mail or fax if required. To visit the offices, please make an appointment. Texfed is located in Johannesburg at the following address:

2nd Floor, East Wing
10 South Boulevard
Liberty Gardens Building - Bruma

Separately, Martin Viljoen, the Chief Executive Officer of the South African Textile Industry Export Council, handles general trade queries. To make a query, log onto http://www.satiec.co.za/CONTACT%20US.htm and fill in the information requested. Mr. Viljoen forwards queries daily.

The Department of Trade and Industry supports any interest in South African products. They will be happy to guide you and will provide additional information and advice if necessary. In particular, they can be contacted on how to do business with a South African firm. The department also encourages South African firms (individuals or groups) to engage with market research and provide some financial support to this purpose. Contact: Ms. Shareen Osman (acting head of the Textiles and Clothing Unit at Trade and Investment South Africa) at

shareen@isa.org.za
Tel: +27 (012) 394 1176.

For information on the South African market and on challenges facing South African textiles and clothing firms—as well as those confronting firms that operate in allied sectors—consult *Pursuit Magazine's* articles website at: http://www.pursuit.co.za/

Firm Contact and Product Information

The following table lists the contacts and products of textile firms that operate in South Africa and that are usually mentioned by South African clothing manufacturers. Some have state-of-the-art technologies; others are internationally competitive, dynamic, and proactive. The list is far from exhaustive. You should, as required, consult the first two websites mentioned in this document. Bear in mind that some firms produce a wider variety of goods than advertised and thus need to be contacted directly.

Name	Contact details	Main Product
	SYNTHETICS	
BMD Textiles (Pty) Limited (Cape Town area)	Managing Director: Dr. Horst Prader Marketing Director: Mr.Gerhard Vogel 108 De Waal Road PO Box 72 Diep River Plumstead 7800 RSA 7801 RSA Tel: +27 21 700 2000 Fax: + 27 21 705 2005 E-mail: bmdtextiles@bmd.co.za Additional e-mail contact on website	Warp and weft knitted fabrics for men's and women's active sportswear (e.g. team wear), sleepwear, blouses, outerwear, housecoats. Fabrics for waistbands, pocketing, linings, upholstery and for industrial end-uses. Rotary and flatbed printing. Brushed, cropped, and suede fabrics. See: http://www.bmd.co.za/ for additional contacts and an expanded product list.
Ninian and Lester (Pty) Ltd (Durban area)	Managing Director: Mr. Fisher PO Box 2221 Durban 4000 RSA Tel: +27 31 700 4211 Fax: + 27 31 700 4193 E-mail: fabric@nintex.co.za	Warp and circular knitting fabrics. Basic single and double jersey fabrics, specialized "fancy"knits including Tactel ®, Qantrel ®, cotton Lycra ® , melange, fleece, lacoste and rib. Among Lycras are nylon and cotton products for swimwear, active wear, and fashion markets. See: http://www.ninian.co.za/
	WOOL (WORSTED & WOOLENS)	
SA Fine Worsteds (Pty) Ltd. (Cape Town area)	Sales Director: Mr. Bill Walker PO Box 88 Maitland\ 7404 RSA Tel: +27 21 593 9100 Tel. sales: +27 21 593 9992 Fax: + 27 21 593 1410 E-mail: worsteds@safine.co.za	Wool and wool mixture yarns Worsted milling cloth Manufacturers of wool & wool-blend fabrics predominantly for outerwear —suits, shirts, jackets and trousers. See: http://www.safine.co.za/

Name	Contact details	Main Product
Hextex Frame Textile Group (Cape Town area but group has regional offices in Durban, Johannesburg and Bloomfontein)		Worsted top-makers, dyers, spinners, weavers and finishers. Color woven, top quality worsted apparel fabrics in 100% merino wool, wool blends—apparel fabrics for women, men, corporate wear and work wear in a range of weights from 150grms to 500grms per square meter—and multiblends. Career uniform fabrics and flame-retardant fabrics. Fabrics with applied finishes, such as Teflon, and washable treatments on wool. Yarns specifically for knitted applications using Hercosett treated tops. Luxury fabrics incorporating fine fibers such as cashmere, mohair, and silk. Color woven seasonal ranges are produced twice yearly. See: http://www.frame.co.za/hextex.php
COTTON & AL.		
Frame Textile Frame Textile Group (Durban area but group has regional offices in Cape Town, Johannesburg and Bloomfontein)	Tel: +27 31 710 4444 or +27 31 450 9444 Fax: +27 31 705 6329 or +27 31 469 3215 124 Escom Road PO Box 81 New Germany New Germany 3620 RSA 3620 RSA E-mail: export@frame.co.za	100% Cotton yarns, carded or combed. Poly-cotton yarns. Woven, knitted, non-woven fabrics. Loomstate, bleached, dyed or printed woven fabrics in standard or specialty finishes. Genuine indigo dyed denim; color woven See: http://www.frame.co.za/home.php
Team Puma	Sales Manager: Mr. A Wynne Mymona Crescent PO Box 2054 Athlone Ind 2 Cape Town Cape Town 8000 RSA Tel: +27 21 699 9000 Fax sales: +27 21 699 9002 Fax admin: +27 21 699 9003 E-mail: sales@sherco.co.za admin@sherco.co.za	Weft knitted fashion and sportswear fabrics 100% cotton, cotton lycra (lycra assured), polyester-cotton blends across a range of constructions. Special finishes: low shrink, soil release, crease recover, brushing. Commission knitters, dyers, printers, and finishes. Panel printing See: http://www.sherco.co.za/

<table>
<tr><th>Name</th><th>Contact details</th><th>Main Product</th></tr>
<tr><td>Da Gama Textile Company Ltd

(Eastern Cape area but with regional offices in Cape Town,, Durban and Johannesburg)</td><td>Export Division: Mike Toet

PO Box 753

East London

5200 RSA

Tel: +27 21 745 2000

Fax: + 27 21 705 2005

E-mail: motet@dagama.co.za</td><td>Spinners of combed and card 100% cotton polyester/cotton and other fiber blends. Weave a fill range of spun yarns.

See: http://www.dagama.co.za/</td></tr>
<tr><td>Berg River Textiles

Frame Textile Group

(Cape Town area but group has regional offices in Durban, Johnannesburg and Bloomfontein)</td><td></td><td>Spinning, weaving, dyeing, printing, finishing

Cotton and polycotton yarn. Cotton and polycotton woven fabrics in printed or dyed form.

See: http://www.frame.co.za/bergriver.php</td></tr>
<tr><td colspan="3">DENIM</td></tr>
<tr><td>DeNim</td><td></td><td></td></tr>
<tr><td>Novel</td><td></td><td></td></tr>
<tr><td colspan="3">MISCELLANEOUS</td></tr>
<tr><td>Mediterranean Textile Mills (Pty) Ltd.

(Durban area)</td><td>Sales Director: Mr. Stephen Kitshoff

Agent for international sales: Ms Lindsay Meyer

Kelly Road Private Bag 1020

Hammersdale Hammersdale

KZN 3700 RSA

Tel: +27 31 736 2015

Fax: + 27 31 736 1497

E-mail: skitshoff@mtn.co.za or lmeyer@mtn.co.za</td><td>A vertical mill with spinning, twisting, weaving, dyeing, and finishing divisions spread over two factory sites.

The main business of the company is to produce fabric suitable for apparel, made from a blend of polyester and viscose. Linen is sometimes included in the blend, and Lycra is often introduced to give stretch properties to these fabrics. The fabric range includes piece-dyed as well as yarn-dyed fabrics, offered in a variety of weaves, colors, and finishes in weights ranging from 150 to 250 grams/sqm.

The company also produces melton fabric made from New Wool as well as jacketing fabric from Regenerated Wool and Synthetics.

See: http://www.bmd.co.za/</td></tr>
</table>

Name	Contact details	Main Product
Gelvenor Textile (Pty) Ltd. (Durban area with regional offices/agents in Johannesburg, Capte Town and Port Elizabeth)	Sales Director: Mr. C.I. Brookes PO Box 656 PO Box 22 Durban Hammersdale 4000 RSA 3700 RSA Tel: +27 31 736 1116 Fax: + 27 31 736 1625 E-mail: exports@gelvenor.co.za	A high tech company involved with industrial, technical, and specialized fabrics that are engineered for performance and reliability. Leaders in specialty apparel for sport and leisurewear, satins and other high performance outerwear fabrics, in school wear and as corporate wear (ISO 9002 and ISO 14001). Niche market applications. See: http://www.gelvenor.com